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October Term, 1997

AT&T Corp., *et al.*,

Petitioners,

vs.

Iowa Utilities Board, *et al.*,

Respondents,

And Related Cases.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF AMICUS CURIAE COVAD COMMUNICATIONS COMPANY IN SUPPORT OF PETITIONERS FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA

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CONSENT OF PARTIES

Pursuant to Rule 37 of the Rules of Court, all the parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of the Court.[1]

QUESTION PRESENTED

This brief addresses a single question raised by the Petitioners in this case: Whether the Federal Communications Commission has authority to adopt a national pricing methodology for Unbundled Network Elements.

INTEREST OF THE *AMICUS CURIAE*

Covad Communications Company ("Covad") is a Competitive Local Exchange Carrier ("CLEC") that provides high-speed, data-oriented telecommunications services. Covad was founded eight months after passage of the Telecommunications Act of 1996 in direct reliance on the Federal Communications Commission ("FCC") order at issue in this case. The Company's interests have been adversely affected by the decision of the court below.

Since its recent founding, Covad has built an all-digital,[2] all-packet[3] telecommunications network in the San Francisco Bay

1. Counsel for a party did not author this brief in whole or in part, and no person or entity, other than *amicus curiae*, has made a monetary contribution to the preparation or submission of the brief.

2. Digital technology uses electronic or optical "pulses" to represent the user's information. In contrast, traditional telephone networks, such as those deployed by the Incumbent Local Exchange Carriers ("ILECs"), rely on analog technology, which employs a continuous electrical signal that varies in frequency, to transmit information. The absence of frequency variations contributes to the superior quality of sound and video transmitted digitally.

3. A packet-switched network breaks user information into (Cont'd)

area that passes approximately one million homes and businesses. Covad has announced plans to expand its network to five other metropolitan areas in the coming year. Covad's advanced telecommunications network is used by small businesses and residential subscribers who seek affordable, high-speed access to the Internet in order to access information stored in computer servers anywhere in the world.[4] The Covad telecommunications network also is used by employees who work at home and connect to their company's multi-state and multi-national computer networks.

Covad's construction of its network would not have been possible without the provisions of the Telecommunications Act of 1996 that are under review in this case. In particular, Section 251(c)(3)[5] allows a CLEC, such as Covad, to enter the local telecommunications market by combining its own facilities with Unbundled Network Elements ("UNEs"). UNEs, which are leased from Incumbent Local Exchange Carriers ("ILECs"), are

(Cont'd)
individuals "packets" (sometimes called "cells" or "frames"), routes each packet over one of many possible transmission paths, and reassembles the packets at the point of reception. Packet-switched networks differ from the ILECs' circuit-switched networks, which create a temporary dedicated physical connection between the caller and the recipient. Packet-switched networks are especially well suited for data communications.

4. A server is a computer that is used to store information, such as a World Wide Web home page, which can be retrieved by an interested party. *See, infra*, n.29 (describing the operation of the World Wide Web).

5. The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996), substantially amended the Communications Act of 1934, 47 U.S.C. §§ 151, *et seq*. For simplicity, all references to Sections are to the new sections of the Communications Act.

the physical "building blocks" of the ILECs' networks. Among the most critical of the UNEs is the "local loop," the wires running between almost every home and business in the United States and the ILEC "central office" that serves that customer. The Telecommunications Act directs the FCC to ensure that ILECs make UNEs available to CLECs at just and reasonable prices. *See* 47 U.S.C. §§ 251(c)(3), 251(d)(1).

Covad provides high-speed local telecommunications services by leasing the local loop from the ILEC in its service area and locating digital subscriber line ("DSL") equipment on the customer's premises and at the ILEC central office serving that customer.[6] From the central office, traffic is carried over high-capacity lines[7] to Covad's regional data aggregation center and, from there, to the user's Internet Service Provider ("ISP") or company computer network.

Covad's DSL network allows users to send and receive information over the existing local loop at much faster rates than conventional methods offered by the ILECs.[8] For example,

6. The DSL equipment located at the subscriber's premises is referred to as a DSL modem. The DSL equipment located at the ILEC's central office is referred to as a Digital Subscriber Line Access Multiplexer ("DSLAM"). A diagram depicting the Covad network is attached to this brief as Appendix One.

7. These lines include T1 lines (which carry data at the rate of 1.544 million bits per second), DS3 lines (which carry data at the rate of 45 million bits per second), and OC3 lines (which carry data at the rate of 155.52 million bits per second).

8. There are a number of variants of DSL technology, including Asymmetric DSL ("ADSL"), High bit rate DSL ("HDSL"), ISDN DSL ("IDSL"), and Very high bit rate DSL ("VDSL"). Collectively, these technologies often are referred to as xDSL. From the customer's perspective, the most significant difference among these technologies is the speed at which they can transport information.

an ILEC customer that has a personal computer and a standard analog modem generally can receive information over the local telephone network at speeds no greater than *56 thousand* bits per second. Covad's DSL service, in contrast, allows the customer to receive information over the same facilities at speeds up to *1.5 million* bits per second.[9]

Because DSL technology uses the existing local loop infrastructure, Covad's prices are substantially lower than the prices that the ILECs charge for services that require the deployment of entirely new facilities (such as end-to-end fiber optic links) to provide transmission service at equivalent speeds. Thus, Covad has helped to fulfill one of the Telecommunications Act's main goals: promoting the rapid deployment of advanced telecommunications services at affordable prices. *See* 47 U.S.C. § 157 (statutory notes).

SUMMARY OF ARGUMENT

In the Telecommunications Act, Congress created a "pro-competitive, deregulatory, national policy framework" designed to replace State-created regulated monopolies with competitive markets. The decision of the court below, however, has radically altered the division of responsibility between the FCC and the States established in the Act. In particular, the court held that the FCC cannot require the States to implement a uniform national methodology designed to ensure that the prices ILECs charge for UNEs are just and reasonable. Rather, in the court's view, each State has exclusive and unfettered authority to establish UNE prices.

9. By way of example, a user who seeks to download a 5 megabyte file — which is large enough to hold approximately 1 minute of video programming — would have to wait over *20 minutes* using traditional telephone technology. A user that obtained Covad's DSL service, in contrast, could download this information in just *27 seconds*.

The States' exercise of this judicially created authority has had a significant adverse effect on entrepreneurial companies, such as Covad, that are seeking to enter the local telecommunications market. Two years after adoption of the Act, many States have not issued a final order setting UNE prices. Where UNE prices have been set, they vary considerably — with some States mandating rates that plainly are not cost-based. For example, the price of an unbundled loop used to provide DSL service is *ten times higher* in Houston than in Chicago. Consequently, Covad has had to shelve plans to enter several significant markets. The end-result has been to deprive consumers of the benefits of the competitive local telecommunications market that Congress sought to create.

The conclusion of the court below that the FCC lacks any authority over UNE pricing is premised on two fundamental errors. First, the court erroneously concluded that Section 252 grants the States exclusive jurisdiction to set UNE prices. Second, the court wrongly held that, because UNEs are "fundamentally intrastate in character," Section 2(b) precludes the FCC from establishing a national pricing methodology for these facilities.

The court erred by finding that Section 252 — which provides that, in any arbitration, the State regulatory authority is to set UNE prices at a just and reasonable level — strips the FCC of authority to adopt a national pricing methodology for UNEs. In adopting the Telecommunications Act, Congress divided responsibilities between the FCC and the States. Section 251 unambiguously gives the FCC authority to adopt regulations necessary to implement the statutory requirement that ILEC rates for UNEs be just and reasonable. The court eviscerated this grant of authority by holding that Section 251 merely acts as a "time constraint" that gave the FCC six months to adopt regulations implementing a handful of statutory

provisions that *expressly* refer to FCC regulations. Rather than gutting the FCC's authority under Section 251, the court should have deferred to the FCC's reading of the statute. Under the FCC's approach, the agency may adopt a binding pricing methodology for UNEs, which the State regulatory authorities must apply in any arbitration to establish the specific rate that an ILEC is to charge.

The court also erred by finding that Section 2(b) — which limits the FCC's authority over facilities used to provide intrastate telecommunications services — prevents the FCC from adopting any pricing standards for UNEs. The court's first mistake was to assume that UNEs are used almost exclusively to provide intrastate telecommunications service. This is demonstrably incorrect. Covad's customers extensively use its UNE-based network to access information stored in computer servers outside their home State. The court further erred by holding that, even though UNEs are "sometimes" used to transport interstate traffic, the States have the exclusive and unfettered right to set UNE prices because those facilities are "fundamentally intrastate in character." This analysis is flatly inconsistent with the long-standing recognition, by numerous Courts of Appeals, that the FCC has authority to regulate physically intrastate facilities to the extent they are used to provide jurisdictionally interstate telecommunications services.

While the data communications carried over Covad's UNE-based network cannot readily be separated into interstate and intrastate categories, a very significant portion of this traffic plainly is jurisdictionally interstate. Consequently, the application of State pricing methodologies to the UNEs that Covad uses to provide service has prevented the FCC from applying its TELRIC methodology to facilities used to provide interstate telecommunications services. Such "reverse preemption" plainly violates the jurisdictional division of authority embodied in Section 2(b).

I.

THE EIGHTH CIRCUIT'S DECISION IS IMPEDING CONGRESS' EFFORTS TO CREATE A COMPETITIVE LOCAL TELECOMMUNICATIONS MARKET.

Historically, most States opposed competition in the local telecommunications market. Indeed, on the eve of the adoption of the Telecommunications Act, thirty-nine States had laws or regulations in effect that prohibited or restricted the competitive provision of telecommunications service.[10] In the Telecommunications Act, Congress created a "pro-competitive, deregulatory national policy framework"[11] designed to replace the State-created regulated monopolies with competitive markets.[12]

Congress crafted a two-pronged strategy to advance its pro-competitive national policy. As a start, Congress voided the legal restrictions on telecommunications competition adopted by the States.[13] Congress recognized, however, that eliminating legal

10. *See* National Association of Regulatory Utility Commissioners, Report on the State of Competition in Intrastate Telecommunications 203-05 (Sept. 1, 1994) (listing states); *see also* H.R. REP. No. 104-204, at 50 (1995), *reprinted in* 1996 U.S.C.C.A.N. 10, 14 ("[T]he majority of States restrict full and fair competition in the local exchange, either by statute or through the public utility commission's regulations.").

11. CONF. REP. No. 104-458, 104th Cong. 2d Sess. 1 (1996).

12. *See* H.R. REP. No. 104-204, at 48, *reprinted in* 1996 U.S.C.C.A.N. 10, 11 ("Technological advances would be more rapid and services would be more widely available and at lower prices if telecommunications markets were competitive rather than regulated monopolies.").

13. *See* 47 U.S.C. § 253(a) ("No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.").

barriers to competition would not be sufficient: this would merely turn the ILECs' *de jure* monopolies into *de facto* monopolies, with little prospect that the American people would soon reap the benefits of competition. In order to "jump start" the competitive process, Congress also required the ILECs to break their networks into individual building blocks — UNEs — and to make those facilities available to new entrants at just and reasonable rates. *See* 47 U.S.C. §§ 251(c)(3), 251(d)(1).

Acting pursuant to an express grant of statutory authority, s*ee id.* § 251(d)(1), the FCC specified the network elements that the ILECs must unbundle.[14] The FCC further directed the States to apply a pricing methodology known as Total Element Long-Run Incremental Cost ("TELRIC"), which is intended to ensure that the rates that ILECs charge CLECs for UNEs are just and reasonable.[15] The TELRIC methodology seeks to estimate the prices that would exist for UNEs if they were sold in a competitive market.[16] The FCC concluded that setting prices in accordance with this methodology is essential to promote economically efficient entry into the local telecommunications market.[17]

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14. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, 15683-775 (1996) ("*Local Competition Order*"), *aff'd in part and vacated in part sub nom. Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997), *aff'd in part and vacated in part sub nom. Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *cert. granted*, 66 U.S.L.W. 3484 (U.S. Jan. 26, 1998).

15. *Id.* at 15844-56; 47 C.F.R. §§ 51.503, 51.505.

16. *Local Competition Order*, 11 FCC Rcd at 15846.

17. *Id.*

Covad has used the statutory right to purchase UNEs to construct its state-of-the-art digital network.[18] However, the decision of the Eighth Circuit — which vacated the pro-competitive pricing rules adopted by the FCC, and held that the State regulatory authorities have exclusive and unfettered authority to set UNE prices — allows the States to set those prices at levels that create an insurmountable barrier for entrepreneurial companies such as Covad that seek to enter the local telecommunications market.

The prices that some State regulatory authorities have established for the local loop have been an especially serious obstacle to Covad's effort to bring the benefits of competition to additional markets.[19] Without a national standard, the price of these loops varies dramatically from State to State.[20] A comparison of loop prices in Illinois and Texas is illustrative. The Illinois Commerce Commission has set the monthly charge for loops at $3.72 in urban areas, $10.02 in suburban areas, and $11.53 in rural areas.[21] The State Commission has further

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18. Covad uses the same two-wire local loops that the ILECs use to provide analog service. Covad can use most of these loops "as is." However, approximately fifteen percent of the loops that the Company orders require minor "conditioning" to make them suitable for its digital service. Such conditioning is not substantially different from the conditioning that ILECs often perform in order to make these loops useable for their analog services.

19. A chart comparing loop costs in several States is attached as Appendix Two.

20. In many States, moreover, Covad is required to pay a premium for loops capable of carrying digital traffic.

21. *See AT&T Communications of Illinois, Inc. Petition for Arbitration of Interconnection Rates, Terms and Conditions and*

(Cont'd)

determined that the price of loops certified to carry analog or digital traffic should be the same.[22] In Texas, by contrast, the Public Utility Commission has established prices for loops that are significantly higher than in Illinois. A CLEC that seeks to obtain loops certified to carry digital traffic in Texas must make a monthly payment of $34.91 in urban areas, $37.54 in suburban areas, and $46.09 in rural areas.[23] The end-result is that the price a CLEC must pay to obtain a loop certified to carry digital traffic is *ten times more* in Houston than in Chicago.

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Related Arrangements with Illinois Bell Telephone Company d/b/a/ Ameritech Illinois, Docket No. 96-AB-003 (Ill. Comm. Comm'n, Aug. 1, 1996); *Ameritech Illinois Petition for Arbitration of Interconnection Rates, Terms and Conditions and Related Arrangements with AT&T Communications of Illinois, Inc.*, Docket No. 96-AB-004 (Ill. Comm. Comm'n, Aug. 2, 1996).

22. *See id.* This approach is consistent with cost studies, prepared by the ILECs and filed at the FCC before the Telecommunications Act was passed, which show that the costs of loops certified to carry analog or digital traffic are virtually identical. *See Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982, 16028-32 (1997) ("*Access Charge Order*") (comparing costs of analog-certified loops and loops which have been certified for Basic Rate Integrated Service Digital Network ("ISDN") service). Indeed, NYNEX submitted data showing that loops certified for digital traffic actually cost *less* than analog-certified loops because they can be tested and maintained remotely. *See id.* at 16197-99.

23. *See Petition of MFS Communications Company, Inc. for Arbitration of Pricing of Unbundled Loops*, Docket Nos. 16189, 16196, 16226, 16285, 16290, 16455, 17065, 17579, 17587, 17781, Arbitration Award (Tex. Public Utility Comm'n, Dec. 17, 1997). The monthly charge for an analog-certified loop in Texas is $12.14 in urban areas, $13.65 in suburban areas, and $18.98 in rural areas. *See id.* The State authorities thus have imposed a premium of nearly 200 percent for digital-certified loops.

The disproportionately high loop prices in some States cannot be based entirely on higher costs in those locations. Rather, these differentials must reflect a decision by the regulatory authorities in those States to price UNEs at levels well in excess of the level that would exist in a competitive market. For example, in one State, the Legislature apparently directed the regulatory authorities to set UNE prices based on historic cost. *See* Telecommunications Regulatory Reform Act of 1997, 1997 Ark. Acts 77, Section 9(E) (Feb. 4, 1997) (Arkansas).[24]

State regulatory decisions that set loop prices at levels far in excess of those that would exist in a competitive market have a significant adverse impact on Covad's ability to extend its network to additional States. There is broad consensus in the industry that the "price point" for mass-market acceptance of DSL service will be approximately $40 per month.[25] Indeed, U S WEST currently offers DSL service in several States at that price.[26] Plainly, Covad cannot profitably offer a competing DSL-based transport service if the cost of only one element of that service — the local loop — is close to, meets, or exceeds $40 per month. Consequently, Covad has had no choice but to

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24. In a competitive market, sellers do not base their prices on historic costs. Rather, they set prices at a level equal to the marginal cost of the most efficient provider. Firms that cannot profitably sell their goods or services at that price exit the market.

25. This is comparable to prices now being charged for equally high-speed access services provided over cable systems. Forrester Research, Inc., The Forrester Report, *Cable Modems Kick In*, Jan. 1997.

26. *See, e.g.*, U S WEST Communications Advanced Communications Services Tariff, New Mexico, issued Jan. 26, 1998, section 8, page 9, release 1; *see also 1500-kbps Modems for Christmas? Not for Most of Us*, PC World, Apr. 1998 at 64.

shelve its plans to provide service in Texas. Covad may have to do the same in other States. The loss of market opportunities as a result of State regulatory decisions obviously harms Covad. More importantly, however, the Eighth Circuit's decision to give the States free reign to set UNE prices plainly undermines Congress' goal of rapidly bringing the benefits of a competitive local telecommunications market to *all* Americans.

Unless this Court acts, there is little hope that this situation will soon improve. Many States — including Washington and California — have yet to adopt final prices for UNEs, despite the fact that the deadlines contained in Section 252 have long since passed. *See* 47 U.S.C. § 252(b)(4)(c) (requiring State regulatory authorities to resolve disputed issues within nine months after a CLEC makes an initial request to an ILEC). Until they do, it will not be possible to appeal their decisions to the Federal District Courts, as provided for in the statute. *See id.* § 252(e)(5). Even then, however, it may take years for a single national standard to emerge from case-by-case adjudications in courts throughout the country.

II.

IN DETERMINING THAT THE STATES HAVE EXCLUSIVE AND UNFETTERED AUTHORITY TO SET PRICES FOR UNBUNDLED NETWORK ELEMENTS, THE EIGHTH CIRCUIT MISREAD CLEAR STATUTORY PROVISIONS, MISUNDERSTOOD CRITICAL FACTS, AND MISAPPLIED WELL-SETTLED PRECEDENT.

As demonstrated above, the Eighth Circuit's decision to allow States to exercise exclusive and unfettered authority over UNE prices is depriving consumers of the benefits of a competitive market. This outcome is not mandated by the Telecommunications Act. Rather, it results from two fundamental errors made by the court. First, the court erroneously concluded

that Section 252 grants the States exclusive and unfettered jurisdiction to set UNE prices. Second, the court wrongly held that, because UNEs are "fundamentally intrastate in character," Section 2(b) precludes the FCC from adopting any pricing standards for these facilities.

A. Sections 251 and 252 Empower the Federal Communications Commission to Adopt a National Pricing Methodology, Which the States Must Implement.

In its decision, the Eighth Circuit held that Section 252 strips the FCC of authority to adopt a pricing methodology applicable to UNEs. Neither the words nor the legislative history of the Telecommunications Act support this conclusion. To the contrary, the Act expressly grants the FCC the authority to establish a pricing methodology for UNEs, which the States must use in any arbitration.

In adopting the Telecommunications Act, Congress divided responsibilities between the FCC and the States. Section 251 requires that UNE rates be "just, reasonable, and nondiscriminatory in accordance with the . . . requirements of this section and section 252." 47 U.S.C. § 251(c)(3). Section 251(d)(1), in turn, directs the FCC to adopt rules "necessary . . . to implement the requirements of this section." *Id.* § 251(d)(1). Taken together, these provisions unambiguously grant the FCC authority to adopt regulations governing UNE pricing. At the same time, Section 252 provides that, in any arbitration between an ILEC and a CLEC, "a State Commission shall . . . establish any rates . . . for network elements . . . [at] just and reasonable rate[s]." *Id.* §§ 252(c)(2), 252(d)(1).

The court below sought to reconcile Sections 251 and 252 by eviscerating the FCC's authority under Section 251. The court reasoned that the "plain language" of Section 252

"authorize[s] the State commissions to determine the prices an incumbent LEC may charge for [UNEs]." *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 794 (8th Cir. 1997). By contrast, the court read Section 251(d)(1) "primarily as a time constraint" that gave the FCC six months to adopt regulations to implement a handful of statutory provisions that *expressly* refer to FCC regulations. *Id.* By doing so, the Court violated a cardinal rule of statutory construction: wherever possible, different sections of a statute should be interpreted so as to give effect to each provision. *See, e.g., Walters v. Metro. Educ. Enters.*, 117 S. Ct. 660, 664 (1997) ("Statutes must be interpreted, if possible, to give each word some operative effect.") (citation omitted); *United States v. New York & Cuba Mail S.S. Co.*, 269 U.S. 304, 305-06 (1925) (recognizing "fundamental canon, that a statute must be construed, if possible, as a harmonious whole, and in such a way as to give effect to all its parts.").

Rather than gutting the FCC's statutory authority, the court should have deferred to the FCC's reading of the statute. In the *Local Competition Order*, the agency concluded that Congress intended for it to play a quasi-legislative role, while the State regulatory authorities are to play a quasi-judicial role. Under this approach, the FCC has authority to adopt a binding *methodology* designed to ensure that an ILEC fulfills its statutory obligation to make UNEs available at just and reasonable prices. At the same time, in any arbitration, the State regulatory authorities are to apply the Federal methodology to establish *specific rates*. This interpretation is consistent with the terms of Section 252(c), which directs the State commission to "ensure" that its decision in any arbitration meets "the requirements of Section 251, including the regulations prescribed by the [FCC] pursuant to section 251." 47 U.S.C. § 252(c)(1).

This interpretation also is consistent with the structure of the Telecommunications Act, which seeks to ensure

implementation of Congress' pro-competitive policy by imposing a series of Federal "checks" on the authority of the States. For example, Congress provided that if a State fails to carry out its Federal obligation under the Act, the FCC is to "preempt[] the State commission's jurisdiction" and fulfill the obligations itself. *Id.* § 252(e)(5). Similarly, Congress specified that any decision made by a State regulatory authority pursuant to this legislation is subject to judicial review by a Federal district court. *See id.* § 252(e)(6).

In each of these cases, the Federal entity (whether the FCC or the district court) must apply a *Federal* standard in order to fulfill its statutory obligation. This inevitably will require the FCC or the Federal courts to develop a *Federal* pricing methodology. It defies credulity to argue that the FCC was powerless to adopt a Federal pricing methodology at the outset of the process of opening-up the local market to competition, even though the agency and the courts will be required to develop such a methodology on a case-by-case basis over time.

B. Section 2(b) Does Not Preclude Federal Communications Commission Regulation of Unbundled Network Elements Used to Provide Interstate Services.

The Eighth Circuit also found that Section 2(b) of the Communications Act — which limits the FCC's ability to set "charges ... for or in connection with intrastate telecommunications service" — precludes the FCC from adopting any pricing standards for UNEs. The court based this conclusion on two assumptions: (1) UNEs are almost always used to provide jursidictionally intrastate service, *Iowa Utils. Bd.*, 120 F.3d at 796, 799, and (2) limited use of UNEs to provide interstate service does not provide the FCC with *any* jurisdiction over these facilities because they are "fundamentally intrastate in character." *id.* Both of these assumptions are incorrect.

1. Unbundled Network Elements are used extensively to provide interstate services.

The court's first mistake was to assume that UNEs are used almost exclusively to provide intrastate telecommunications service. This is demonstrably incorrect. While UNEs are *physically* intrastate facilities, the Telecommunications Act does not restrict their use to the provision of *jurisdictionally* intrastate services. To the contrary, Section 251(c)(3) provides that ILECs must lease UNEs to "any requesting telecommunications carrier" for the provision of any "telecommunications service." 47 U.S.C. § 251(c)(3). Indeed, the Eighth Circuit recognized these facilities "sometimes" are used for the provision of interstate telecommunications services. *See Iowa Utils. Bd.*, 20 F.3d. at 799 & n.20. However, the court wrongly assumed that the amount of interstate traffic carried over the local network is relatively small and, therefore, that State regulation of these facilities would have only a "tangential impact on interstate services." *Id.* at 800.

The Eighth Circuit plainly focused on only one type of interstate use of the local network: the origination and termination of circuit-switched long-distance voice telephone calls. *See id.* at 799 n.20. The court ignored the fact that the local network increasingly is used to carry data traffic, such as data transmitted during lengthy on-line "sessions" in which a user "downloads" information from the Internet. Indeed, several of the Bell Operating Companies ("BOCs") have predicted that, by the year 2000, data traffic will account for between 25 to 30 percent of all traffic carried on the telephone network.[27] Such

27. *See, e.g.*, Comments of U S WEST at 2-3 (filed May 8, 1996) ("Internet usage is growing exponentially .... [B]y the year 2000, as much as 30% of all local exchange traffic may be traffic which ultimately uses the Internet. A high percentage of this traffic will be (Cont'd)

traffic is far more likely than voice traffic to be interstate.[28]

Covad's experience provides clear evidence that a significant (and ever-increasing) portion of traffic carried over the physically intrastate network is jurisdictionally interstate. Covad's UNE-based network is extensively used by subscribers with personal computers seeking to access information located on the World Wide Web.[29] A subscriber who seeks to do so sends an information request over Covad's network to his or her information service provider. The subscriber's request is broken into numerous data packets, which are then routed to computer servers that contain the information requested by the user. During a single on-line session, the subscriber may receive information from computer servers located in several different

(Cont'd)
interstate in nature — much more than the current interstate traffic percentages on the voice network."); Comments of Pacific Bell and Nevada Bell at 11 (filed May 8,1996) (estimating that on-line data calls could comprise up to 25% of Pacific Bell's traffic by the end of the decade), filed in *The Provision of Telecommunications Service via the "Internet" by Non-tariffed, Uncertified Entities*, RM No. 8775.

28. At the present time approximately 15 percent of circuit-switched voice traffic is jurisdictionally interstate. *See* Federal Communications Commission, Federal-State Joint Board, *Monitoring Report*, CC Docket No. 87-339 (May 1997) at Table 4.5.

29. The World Wide Web is a powerful method of accessing information through the Internet. Web "browsers" can combine text and graphical material into a standard interface. The Web also incorporates a "hypertext" system that allows direct links between Web "pages." *See* Federal Communications Commission, Office of Plans and Policy, OPP Working Paper No. 29, *Digital Tornado: The Internet and Telecommunications Policy*, at 20 (Mar. 1997).

States.[30] In most cases, neither the subscriber, nor the ISP, nor Covad knows the location of the servers.[31]

30. Popular content is often "cached" in computer servers located close to major metropolitan areas, while less-popular content may be stored in only one remote location. For example, when a subscriber calls up the box score from last night's basketball game between the Chicago Bulls and the Boston Celtics on the ESPNET SportsZone Web site, that request may be sent to an in-state computer server. However, when the subscriber clicks an icon on his computer screen to request the career statistics of Michael Jordan, who played in that game, that request may be sent to a server in another State. A computer in a third State may perform authorization and billing functions.

31. Because traffic between a subscriber and an ISP is jurisdictionally mixed, and because it often is not possible to determine the portion of this traffic that is jurisdictionally interstate, the FCC has allowed ISPs to use the same State-tariffed local telephone service as other business customers, rather than the federally tariffed interstate access services used by long-distance carriers. *See Access Charge Order*, 12 FCC Rcd at 16133-34. The FCC's decision to delegate regulatory authority to the States, however, does not alter the fact that a significant portion of the traffic that flows between ISPs and their subscribers is jurisdictionally interstate. Consistent with this view, several of the Bell Operating Companies have informed Covad that Sections 51.701 through 51.717 of the FCC's Rules — which require ILECs to compensate CLECs for terminating ILEC-originated intrastate traffic — are not applicable to the ILEC-originated traffic that the CLEC terminates at an ISP's premises. *See* Letter from Patrick Garzillo, Managing Director, Carrier Markets, NYNEX, to Dhruv Khanna, Convergence Law Group, Apr. 15, 1997 ("[T]raffic that is being delivered to Internet Service Providers ... is interstate in nature and not eligible for reciprocal compensation under the FCC's rules."); Letter from P. Doug Garrett, Executive Director, Local Interconnection Industry Market Group, to Tom Regan, Covad Communications, June 16, 1997 (ISP "originating traffic does not become 'local traffic' simply because the FCC permits an ISP to use business local exchange service....").

Covad's local network also is used by employees to "telecommute." In this application, an employee who is working at home sends information to, and receives information from, the computer network located in his or her company's office. These office-based computer networks often are referred to as Local Area Networks ("LANs"). Increasingly, companies with multiple offices located in different States are connecting their LANs together into Wide Area Networks ("WANs"). Thus, an employee working at home in San Francisco can use Covad's network to access information stored in a server in his company's New York office, while another Bay Area employee can use the network to send an e-mail message to her colleagues in the company's Los Angeles and Seattle offices. Because most companies now provide access through their corporate computer networks to the Internet, the employee can send a copy of the e-mail to a friend who lives in Chicago.

Given the significant amount of interstate traffic carried over local network facilities, it is clear that the Eighth Circuit erred when it concluded that State regulation of UNE pricing would have only "a tangential impact on interstate services." *Id.* at 800. To the contrary, State regulation of UNE pricing is having a direct, substantial, and growing effect on the provision of jurisdictionally interstate telecommunications services by CLECs.

2. The Federal Communications Commission has jurisdiction over physically intrastate facilities to the extent of their interstate use.

The Eighth Circuit compounded its factual error with legal error. The court assumed that the presence of "some" interstate traffic on the CLECs' networks did not provide the FCC with *any* authority over UNE pricing because the presence of this traffic did not alter the UNEs' "fundamentally intrastate ...

character." *Id.* at 799. While the Eighth Circuit claimed that it was engaging in a "traditional analysis" of the jurisdictional issues, *id.*, the court's approach is at odds with nearly seventy years of consistent judicial precedent. These cases have consistently recognized that the FCC has authority to regulate local telecommunications facilities to the extent that they are used to provide jurisdictionally interstate services. *See generally,* J. Nadler, *Give Peace a Chance: FCC-State Relations After California III*, 47 Fed. Comm. L.J. 457, 493-501 (1995).

The origin of the established jurisdictional approach is this Court's decision in *Smith v. Illinois Telephone Company*, 282 U.S. 133 (1930). In that case, the Illinois Commerce Commission established the rates that the local telephone company, Illinois Bell, could charge for telephone service in Chicago. The record indicated that *99.5 percent* of the traffic carried over Illinois Bell's local facilities was jurisdictionally intrastate. In developing the rates, however, the State regulatory authorities allocated *100 percent* of the costs of those facilities to the intrastate jurisdiction. On appeal, the three-judge district court — much like the Court of Appeals in the present case — concluded that, because *most* of the traffic carried over the local network was jurisdictionally intrastate, the regulatory authorities could ignore the fact that a portion of the traffic carried over the network was jurisdictionally interstate. *See id.* at 147.

This Court reversed. The Court stressed that "[t]he proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction." *Id.* at 149. While the Court recognized the difficulty of making "an exact apportionment of the property" between the Federal and the State jurisdictions, it made clear that regulatory authorities may not "ignore altogether the actual uses to which the property is put." *Id.* at 150-51. Rather, to the extent that the local network is used to provide even the smallest amount of interstate service, the Federal

regulatory authorities have the right — and, indeed, the obligation — to see that those costs are recovered through federally regulated rates. *See id.* at 148-49.

In the present case, the portion of traffic carried over UNE-based local networks that is jurisdictionally interstate is far greater than it was in *Smith*. Yet, the court below concluded that the FCC lacks *any* authority to ensure that the rates charged for these facilities are just and reasonable because it believed that the amount of interstate traffic is not great enough to alter the "fundamentally intrastate character" of the local network. The Eighth Circuit's jurisdictional analysis plainly is at odds with this Court's decision in *Smith*.

Rather than using the "fundamental character" approach concocted by the Eighth Circuit, the Courts of Appeals have repeatedly held that the FCC has jurisdiction over a physically intrastate facility to the extent that the facility is used to provide interstate communications. As the D.C. Circuit explained in *National Association of Regulatory Utilility Commissioners v. FCC* (*"NARUC II"*):

> The dividing line between the regulatory jurisdictions of the FCC and the States depends on the nature of the communications that pass through the facilities [and not on] the physical location of the lines. *Thus, purely intrastate facilities . . . used to complete even a single interstate call may become subject to FCC regulation to the extent of their interstate use.* Every court that has considered the matter has emphasized that the nature of the communication is determinative rather than the physical location of the facilities used. . . .

746 F.2d 1492, 1498 (D.C. Cir. 1984) (Bork, J.) (emphasis added) (quotations and citations omitted). This approach, the

court made clear, is grounded firmly on the Supremacy Clause. Because virtually all telecommunications facilities are physically intrastate, the FCC simply could not exercise its plenary authority to regulate interstate communications if it "were barred from regulating any facility that carried interstate calls but was physically intrastate." *Id.* at 1499.

In a closely analogous case, *California v. FCC,* 4 F.3d 1505 (9th Cir. 1993) ("*California II*"), the Ninth Circuit affirmed the authority of the FCC to regulate the prices that the ILECs charge for a type of unbundled network elements used for interstate purposes. *California II* grew out of the FCC's decision, in the mid-1980s, to establish a regulatory regime known as Open Network Architecture ("ONA"). The FCC adopted ONA in order to facilitate competition in the market for interstate enhanced services.[32] Under ONA, the BOCs were to unbundle their local networks into basic service elements ("BSEs"), which are network features and functions that enhanced service providers obtain from the BOCs in order to deliver service to their customers. *See Filing and Review of Open Network Architecture Plans,* 4 FCC Rcd 1, 36 (1988) ("*ONA Order*").

In the *ONA Order,* the FCC required the BOCs to file a Federal tariff for any BSE that could be used to provide an interstate enhanced service. California objected, arguing that "because BSEs are . . . [physically] intrastate features and functions, the FCC lacked authority to regulate them." *California II,* 4 F.3d at 1514. The Ninth Circuit rejected this argument. The court explained that, to the extent that BSEs could be used

32. Enhanced services are offerings — such as Internet access, electronic mail, access to on-line databases, and remote data processing — that combine telephone-company-provided transmission services with computer processing. *See* 47 C.F.R. § 64.702(a). The Telecommunications Act refers to these offerings as "information services." *See* 47 U.S.C. § 153(20).

to provide jurisdictionally interstate enhanced services, the FCC has the authority to regulate the price that the BOCs could charge for these network elements. *Id.* at 1515. The court observed that, in effect, "the state is seeking to preempt FCC regulation of [interstate] communication." This attempt at "reverse preemption," the court concluded, violates the division of Federal-State authority embodied in Section 2(b) of the Communications Act. *Id.*

The Eighth Circuit's decision in the present case cannot be reconciled with *Smith, NARUC II, California II,* or any of the numerous other cases that address the division of authority between the FCC and the States. Nor can the approach adopted by the court stand on its own merits. The fatal weakness in the court's approach is revealed in its discussion of the Federal access charge regime. The court recognized, as it must, that the FCC has jurisdiction to regulate the rates that the ILECs charge interexchange carriers ("IXCs") that use the ILECs' local facilities to originate and terminate interstate traffic. Yet, the court insisted that the FCC has no role in regulating the rates that the ILECs charge CLECs to lease the *identical* local facilities in order to provide the *identical* interstate service.

The only distinction that the court could muster is that an ILEC that provides interstate access service to an IXC is offering a "service," while an ILEC that leases a UNE to a CLEC is offering "a direct hookup" to the ILEC's network. *Iowa Utils. Bd.*, 120 F.3d at 799 n.20. This is a distinction without a difference. The extent of the FCC's jurisdiction plainly does not turn on whether the agency is seeking to regulate a telephone company service or whether it is seeking to regulate a telephone company facility used to provide that service. To the contrary, the FCC has authority to regulate both telephone company services and facilities to the extent of their interstate use. Were it otherwise, the FCC would be devoid of power to set depreciation

rates for local telephone company facilities to the extent that they are used to provide interstate services. This, of course, is plainly not the case. *See Louisiana Public Service Comm'n v. FCC*, 476 U.S. 355, 375-76 (1986).

Because UNEs can be (and extensively are) used to provide jurisdictionally interstate service, they are subject to the jurisdiction of the FCC to the extent of their interstate use. While the data communications carried over Covad's UNE-based network cannot readily be separated into interstate and intrastate categories,[33] a very significant portion of this traffic plainly is jurisdictionally interstate. The application of State pricing methodologies to the UNEs that Covad uses to provide service has prevented the FCC from applying its TELRIC methodology to facilities used to provide interstate services. As a result, the FCC has been stripped of its plenary authority to regulate interstate telecommunications. Section 2(b) does not require this result. To the contrary, such "reverse preemption" plainly violates the jurisdictional division of authority embodied in that provision.

33. *See, supra*, pp. 16-19.

CONCLUSION

By adopting the Telecommunications Act, Congress created a comprehensive Federal regime intended to rapidly replace State-created monopolies with competitive markets. The decision of the Eighth Circuit has effectively denied the American public the benefits that Congress sought to provide. Only this Court can set the matter straight.

Covad — on behalf of itself, its customers, and all those who believe in the benefits of competitive markets — respectfully asks this Court to reverse the decision of the Eighth Circuit insofar as it holds that the FCC may not establish the pricing methodology that the States must apply to set UNE prices. At a minimum, the Court should make clear that the FCC may mandate the application of its pricing methodology when UNEs are used to provide jurisdictionally interstate telecommunications services.

Respectfully submitted,

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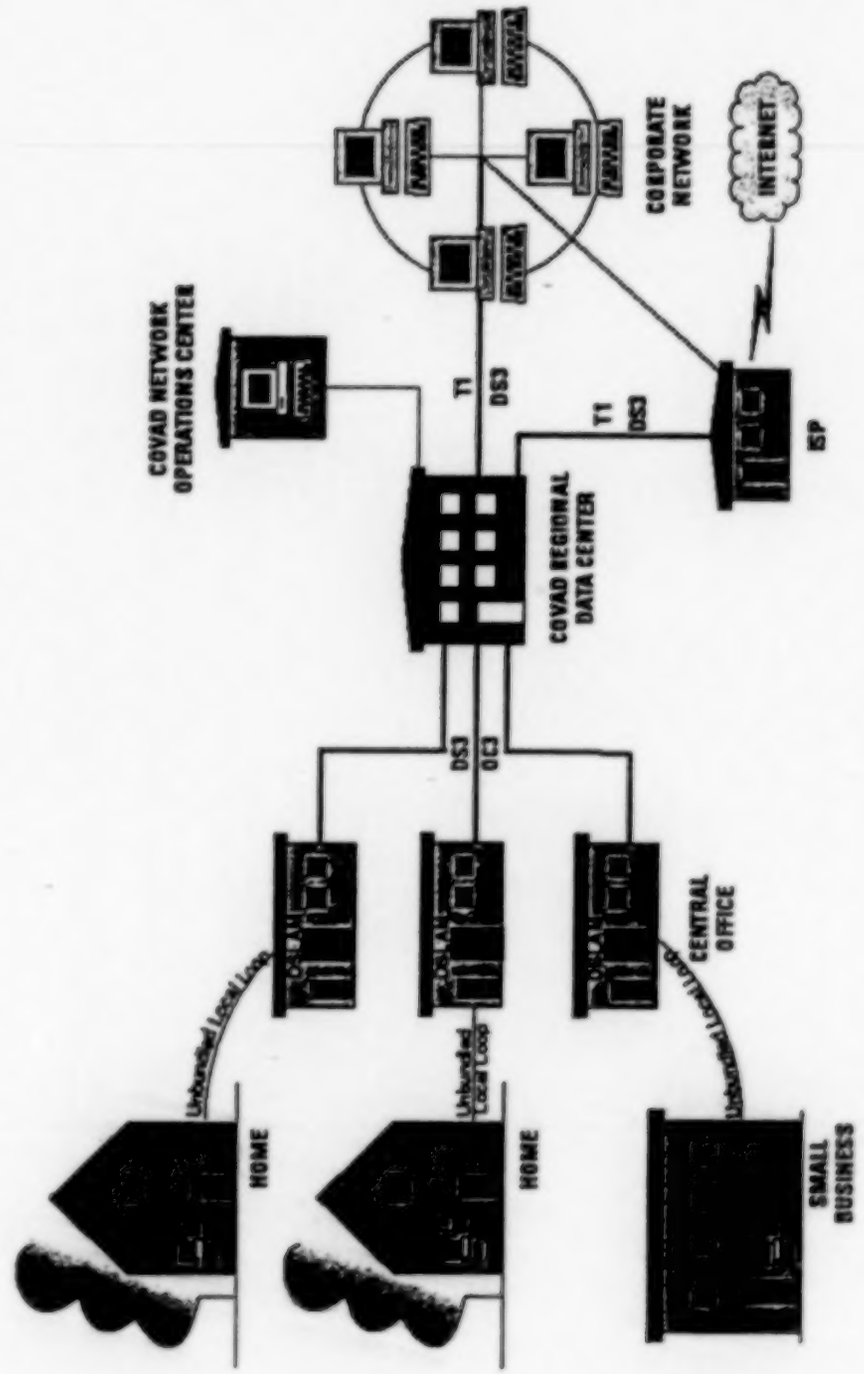
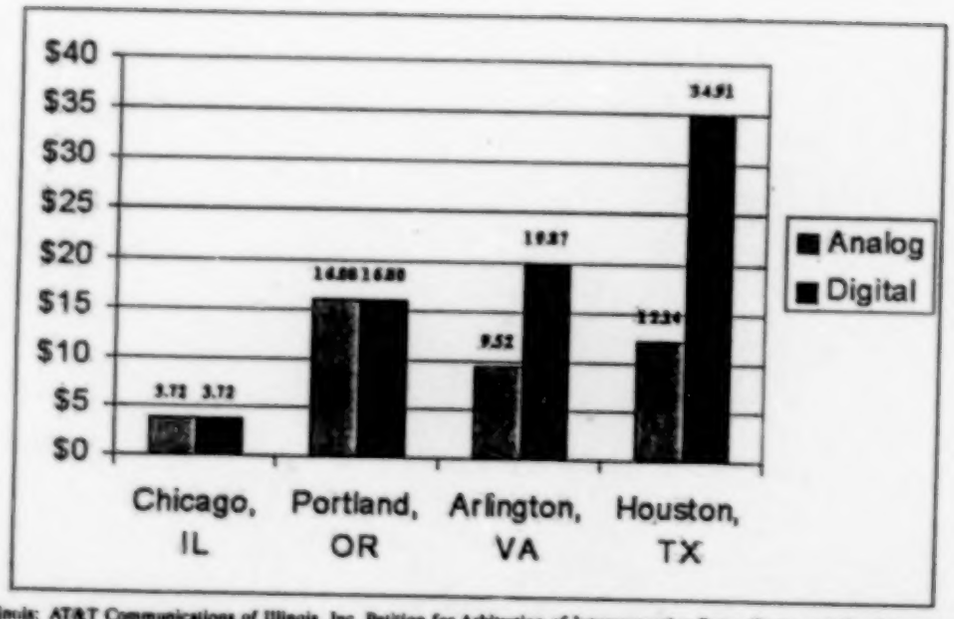
APPENDIX

APPENDIX 1 — THE COVAD NETWORK



APPENDIX 2 — MONTHLY ANALOG AND DIGITAL LOOP PRICES



Illinois: AT&T Communications of Illinois, Inc. Petition for Arbitration of Interconnection Rates, Terms and Conditions and Related Arrangements with Illinois Bell Telephone Company d/b/a/ Ameritech Illinois, Docket No. 96-AB-003 (Ill. Comm. Comm'n, Aug. 1, 1996); Ameritech Illinois Petition for Arbitration of Interconnection Rates, Terms and Conditions and Related Arrangements with AT&T Communications of Illinois, Inc., Docket No. 96-AB-004 (Ill. Comm. Comm'n, Aug. 2, 1996).

Oregon: Agreement for Local Wireline Network Interconnection and Service Resale Between U S West Communications, Inc. and GST Telecom, Inc., Apr. 1, 1997. Order Approving Agreement: Docket No. ARB-18 (Or. Public Utility Commission, May 8, 1997).

Texas: Petition of MFS Communications Company, Inc. for Arbitration of Pricing of Unbundled Loops, Docket Nos. 16189, 16196, 16226, 16285, 16290, 16455, 17065, 17579, 17587, 17781, Arbitration Award (Tex. Public Utility Commission, Dec. 17, 1997).

Virginia: Agreement between Bell Atlantic-Virginia, Inc. and AT&T Communications of Virginia, Inc., Aug. 1, 1997. Order Approving Agreement: Case No. PUC960100 (Va. S.C.C. Sept. 4, 1997).